

Department of Justice/ Federal Trade Commission



Hearings on Single-Firm Conduct: Remedies in Section 2 Cases

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Section 2 Injunction Relief: Can We Learn Anything from the Merger Context?



- Injunctive Relief – Structural vs. Behavioral
- Policy towards remedies well developed in merger context
 - Antitrust Division Policy Guide to Merger Remedies (October 2004)
- What is different about Section 2 Cases?

Prohibiting Unlawful Conduct is Easy... Not Really



- Restore competition through divestiture or “break up”
 - Possible insurmountable organization design problems – mistakes cannot be remedied.
- Prohibit unlawful Exclusive Dealing Contracts.
 - Could be easy to prohibit contractually, but what about practices that mimic exclusive dealing?
- Prohibit the tie.
 - Again could be easy, but mistake may risk loss of substantial integration efficiencies.
- Prohibit the predatory pricing?
 - Remedy itself could easily be anticompetitive.
- Cease and desist orders; revision of relationships between customers or competitors.

- Single Goal: not to enhance competition, but to restore competition.
- Structural remedy strongly preferred.
- Preserves Efficiencies.

“... restoring competition is the only appropriate goal with respect to crafting merger remedies.”

– Antitrust Division Policy Guide to Merger Remedies
(October 2004)

Structural Remedy In Mergers Preferred, Conduct Remedy Discouraged



- Preference for structural remedy is stated in terms of problems with conduct remedies:
 - Direct Costs of Monitoring.
 - Indirect Coasts of efforts to evade the spirit of a decree, while not violating its letter.
 - Could constrain procompetitive behavior.
 - Constrains firms from responding efficiently to changing market conditions.

Positive case for Structural Remedy in Mergers



- Mergers are about changing structure – removing competition between rivals.
- Competition that leads to lower prices, improved quality, and more innovation is lost.
- For example, remedies such as price protection cannot reproduce the multiple dimensions over which competition occurs.
 - Benefits of competition not restored; remedy can be easy to evade, and evasion hard to monitor.

Positive Case for Structural Remedies in Mergers (Cont.)



- One purpose of HSR is to allow assets to be divested before the “eggs are scrambled.”
- Preference is for an existing business entity, already well-defined that has both the ability, and incentive to compete.

There has been a “Market” Test



- The organizational design has already been done in many cases.
- The ability of the assets to compete may have been tested in the pre-merger world.
- Even so, FTC divestiture study (1999) found significant problems.
 - Divestitures of ongoing business were more successful.

Removing Existing Monopoly Power



- In a single firm conduct case, the conduct often arises from the existing monopoly power.
- Thus, relief could change the firm's structure, such that it no longer has the future ability and incentive to restrain competition.
 - Tied to conduct at issue in the case.
- Does that mean looking for a “But For” market structure?

Appropriate Divisional Lines May Not Exist



- Single firm not necessarily drawn neatly in a way that could satisfy a horizontal divestiture.
 - Necessary assets, including intellectual property, to create an immediate going concern where none existed before is a substantial hurdle. Risk of failure appears higher than in a merger case.
 - Rare cases of horizontal separate operating entities that would allow a divestiture of “hard” assets (Exception: Standard Oil, American Tobacco).
 - Rejected in United Shoe Machinery, later in Microsoft.

Goal in Some Cases Could be to Create Conditions that Change Incentives through Vertical Divestiture



- Vertical Divestitures possibly less costly?
- AT&T (1984) was broken up along operating company lines.
 - Even with structural relief required, substantial ongoing monitoring BOC lines of business and interconnection.
- Microsoft – not obvious that Operating System and Applications could be split along clear operating unit lines without huge losses in efficiencies.
 - Ongoing monitoring of interaction between divested entities would be required.

Will the Predicted Market Structure Emerge?



- Assumes that the market would create the hoped for new structure that theory would predict.
- But the market could have easily returned to its existing through acquisition and internal innovation – ultimately the result of network effects.
- No practical experience (unlike in mergers) regarding what assets are needed to compete effectively.

Cost/Benefit Balance: Section 2 vs. Mergers



- Benefits of structural remedy is high in merger context – a market already exists.
- Costs are likely to be low as divestiture can often be accomplished while permitting efficiencies. Where efficiencies cannot be retained with divestitures, case for divestiture may be weaker.
- Absent any experience with competition benefits of divestiture are more uncertain in the case of monopoly.
 - Competitive process is not necessarily enhanced if market could easily revert to monopoly.
- If “But For” market structure is sought, can be difficult to determine appropriate competitive structure.
- Costs could be high in terms of undoing efficiencies derived from a firm’s internal structure.
- May still require ongoing monitoring.

Behavioral Remedies in Section 2



- Biggest problem is recurrence through evasion.
- Exclusive dealing, tying, bundled discounts, etc. can be prohibited broadly.
- Focuses on the effect of entry as a less costly remedy.
- Broad prohibitions may favor rivals (imposing efficiency costs), but cost seems lower relative to uncertain results of divestiture.
 - Favors the competitive process at lower cost by facilitating entry.
 - US vs. Dentsply – prohibition on exclusive contracts.
- Post-remedy incentives are clear – benefits potentially excluded rivals through enhancing ability to compete.

Caveat: Predatory Pricing



- US vs. American Airlines: An irremediable violation?
- Prohibition on lowering prices seems anticompetitive.
- Limiting magnitude of price cuts, or require price cuts to be maintained for a certain period, or limit capacity expansions after market entry.
- Break up the airline? Not clear that hub competition would survive for any length of time.
 - Network effects again.
- Fines may be the only remaining remedy.
- If there is no remedy, is there a case?

- Merger remedies guides point to structural remedies as a preferred outcome.
- The case for divestiture remedies weaker in Section 2 Cases.
- Incidence of the divestiture remedy has been very limited.